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In the Supreme Court of the United States

OCTOBER TERM, 1996

FIRST JERSEY SECURITIES, INC. AND
ROBERT E. BRENNAN,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Both Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b), and Section 21(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(e), confer jurisdiction on federal district courts, on application by the SEC, to grant a "permanent or temporary injunction or restraining order" forbidding acts or practices that violate these statutes. But neither statute confers jurisdiction to order disgorgement of profits received from allegedly illegal acts or practices.

In this case a federal district court ordered petitioners to disgorge $75,000,000. That amount, which includes $53,000,000 in prejudgment interest, is the largest non-consensual disgorgement judgment in the history of the federal securities laws. Both petitioners have been forced into bankruptcy.

The questions presented are:

1. Whether, in the absence of any statutory authorization, federal courts have "broad equitable power" to fashion a disgorgement remedy to effectuate the "deterrence objectives" of the federal securities laws.

2. Whether, in the absence of any statutory disgorgement standards, federal courts may disregard equitable limitations in framing disgorgement orders, thereby requiring a defendant to disgorge money he never received to an entity to whom he owes no debt, and effectively nullifying constitutional and procedural safeguards that apply whenever the government seeks to impose a penalty.

PARENT COMPANIES AND SUBSIDIARIES

First Jersey Securities, Inc., a corporation now in bankruptcy, has no parent companies or subsidiaries that have issued shares to the public.

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v.

SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

First Jersey Securities, Inc. and Robert E. Brennan respectfully petition this Court for a writ of certiorari to review the judgment entered by the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-47a)[1/] is reported at 101 F.3d 1450. The opinion of the district court (App. 48a-104a) is reported at 890 F. Supp. 1185.

[1/] "App." refers to the separately bound appendix to this petition.

JURISDICTION

The court of appeals issued its opinion on December 10, 1996. Petitioners filed a timely petition for rehearing with suggestion for rehearing *en banc*, which was denied on February 27, 1997. App. 219a. This petition is being filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

1. Section 20(b) of the Securities Act of 1933, 15 U.S.C. § 77t(b), provides in pertinent part:

> Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States or United States court of any Territory, to enjoin such acts or practices and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter.

2. In substantially identical terms, Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d), provides as follows:

> Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning

such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

STATEMENT OF THE CASE

1. Introduction. This petition arises from a decision by the court of appeals affirming the largest adjudicated disgorgement award in the history of the federal securities laws. The $75 million judgment at issue, including $53 million in prejudgment interest, was the culmination of a civil action filed more than 10 years earlier by the Securities and Exchange Commission ("SEC"). As a result of the disgorgement judgment, which exceeds the amount of money petitioner Brennan actually received by more than $74 million, both petitioners were forced into bankruptcy.

The two questions presented in this petition are frequently recurring and exceptionally important to the administration of the federal securities laws. The first question is whether there is any statutory basis for disgorgement. That remedy has evolved into the form of ancillary relief most commonly granted to the SEC by federal district courts, even though the statute invoked by the SEC as authority for imposing it does not mention disgorgement at all. In fact, the SEC noted in its 1995 Annual Report (at 1) that, in that year alone, it had "obtained court orders requiring defendants to disgorge illicit profits of over $994 million." Given the mistaken but long-entrenched view of disgorgement held by the lower federal courts, there is great practical need for this Court's review.

The second question presented follows directly from the first. If courts are given the power to imply a disgorgement remedy, every aspect of disgorgement, including the rules defining the amount to be disgorged, must be created by judges on an ad hoc basis. In this case, the Second Circuit fashioned an ad hoc remedy requiring petitioner Brennan to disgorge more than 75 times the profits he received in order to maximize "deterrence." That decision turns the law of disgorgement on its head, greatly expanding the judicially-conferred powers of the SEC and, in the process, creating a split with every other court that has addressed the question. If lower courts can create an implied disgorgement remedy,

then this Court should define the boundaries of the lower courts' discretion to mete out disgorgement awards.

2. **The decision of the district court.** Petitioner First Jersey Securities, Inc. ("First Jersey") was founded in 1974 as a full-service broker-dealer, specializing in the securities of emerging growth companies. App. 105a. Petitioner Robert Brennan served as president or chief executive officer of First Jersey during the period in question. *Id.* at 128a. The disgorgement judgment entered below was based on a determination by the district court that petitioners had violated the anti-fraud provisions of the federal securities laws by charging excessive prices in the retail sales of securities in the over-the-counter market. *Id.* at 48a-104a. On the basis of its finding of excessive markups, the district court ordered petitioners jointly and severally to disgorge the sum of $22,288,099 (the profits earned by First Jersey on the securities at issue), plus $52,689,894 in prejudgment interest. *Id.* at 223a. The district court also enjoined petitioners from violating the securities laws. *Id.* at 222a.

The trial record established that First Jersey was not a one-person operation, but a large business serving customers in many states. According to the district court's findings of fact, from November 1, 1982 through January 31, 1987, First Jersey's organization had six major departments, including Sales and Trading. *Id.* at 105a. From 1984 through January 1987, First Jersey operated approximately 32 retail branch offices and, at its height, approximately 36 retail offices throughout the United States. *Id.* at 106a. As of October 1986, First Jersey had a retail customer base of more than 500,000 accounts. *Id.* at 107a. First Jersey employed approximately 1,200 registered representatives. *Id.* The sheer size of the operation required Brennan to delegate many responsibilities, such as pricing. Tr. 1541-42, 2739, 2823.

According to the undisputed record, although petitioner Brennan personally received a total of $14 million in compensation from First Jersey over the four-year period in question (App. 130a), *less than $1 million* of that amount was attributable to the allegedly improper transactions (*id.* at

228a). The district court nevertheless required him personally to disgorge the full $22 million amount of First Jersey's gross profits from those transactions, plus interest. The district court did so on the ground that Brennan was the owner of First Jersey and was jointly and severally liable for the violations at issue. *Id.* at 99a-101a. The court made no finding that First Jersey lacked a separate existence from Brennan so as to justify piercing the corporate veil, and the SEC sought no such finding.

The district court did not fashion this sweeping relief to compensate the victims of the alleged fraud. Beginning in October 1985 and coinciding with the filing of the SEC's complaint in this case, several class actions were filed on behalf of all of First Jersey's customers with regard to the same securities transactions at issue here. In 1987, after extensive discovery was taken and a consolidated class action complaint was filed, mirroring the SEC's complaint in this case, all plaintiffs agreed to a judicially-approved settlement and released their claims. *Id.* at 230a-247a. Indeed, the SEC repeatedly acknowledged during the proceedings below (*e.g.*, Tr. 555, 1059, 1143-45) that any funds obtained through disgorgement will be paid to the U.S. Treasury and *not* to any victims of the alleged fraud.[2/]

The district court more than tripled the size of the award against Brennan and First Jersey by calculating prejudgment interest at the IRS underpayment rate. App. 101a. Denying petitioners' request that it make specific factual findings with respect to the appropriate rate of interest applicable to any disgorgement award, the court instead opted, without discussion, analysis or factual findings, to calculate interest automatically at the rate proposed by the SEC in every case.[3/] In doing so, the district court also denied petitioners the

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[2/] In its brief submitted to the Court of Appeals (at 47-48), the SEC expressed doubt about what to do with the money, stating that "it is not yet clear where the disgorged proceeds will go."

[3/] The SEC takes the position that courts should apply the IRS underpayment rate, which equals the federal short-term rate plus three percentage points, in all cases regardless of their facts. 17 C.F.R. § 201.600(b).

opportunity to present evidence that the interest should be reduced to reflect delay chargeable to the SEC's own conduct in taking over ten years to pursue the case. *Id.* at 102a.

3. The decision of the court of appeals. The Second Circuit affirmed the disgorgement award on the ground that disgorgement fulfills the "deterrent purpose" of the federal securities laws. *Id.* at 38a. The court nowhere addressed petitioners' arguments concerning the absence of any express disgorgement remedy in the text of the governing statutory provisions. Instead, the court reasoned that "[o]nce the district court has found federal securities law violations, it has broad equitable power to fashion appropriate remedies, . . . thereby effectuating the deterrence objectives of those laws." Throughout its opinion, the court stressed that disgorgement, "unlike an award of damages," serves to punish the defendant financially and thereby deter future violations: "the primary purpose of disgorgement as a remedy for federal securities laws violation is deterrence." *Id.* at 38a, 39a.

The Second Circuit relied on its seminal disgorgement decision, *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301, 1308 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971), for the proposition that disgorgement is necessitated by the generalized "purposes" embodied in the federal securities laws, rather than the statutory text. *Id.* at 38a. The additional Second Circuit decisions cited by the panel (*id.*) uncritically followed the ruling in *Texas Gulf Sulphur*, without attempting to reconcile the disgorgement remedy with the governing language of the federal securities laws, the legislative history, or this Court's recent decisions limiting the creation of implied remedies.

The Second Circuit also made clear that the disgorgement remedy is subject to few, if any, limitations enforceable by appellate courts. As to every objection raised to the disgorgement order, the court simply recited that the district court had "discretion" to resolve such issues. *E.g., id.* at 38a. Initially, the Second Circuit ruled that the district court's disgorgement award — even to the extent that it "ordered [petitioner Brennan] to disgorge more than the profits he personally received from the transactions in

question" — fell "within the court's discretion." *Id.* at 40a. The court further concluded that because Brennan, as the owner of First Jersey, "could" (but did not) "request a check in any amount at any time and the Firm would issue one to him," it was once again within the district court's "discretion" to extend disgorgement to any personal enrichment that Brennan *might* have obtained. *Id.* With regard to the award of $53 million in prejudgment interest, the Court once more invoked the district court's "broad discretion," and once again reasoned that "[i]n an enforcement action brought by a regulatory agency, the remedial purpose of the statute takes on special importance." *Id.* at 41a. Finally, given the Second Circuit's characterization of disgorgement as "remedial" or "equitable" rather than "punitive" (*id.* at 38a), the court rejected without discussion petitioners' contention that the SEC's claim was barred under the statute of limitations that applies to government penalty proceedings, and that the $75,000,000 "deterrent" order in this case was meted out without a trial by jury in violation of the Seventh Amendment.

Although the Second Circuit's decision addressed several controversial issues on the merits, this petition is concerned only with disgorgement.

REASONS FOR GRANTING THE PETITION

The decision of the Second Circuit raises important issues of statutory interpretation that are critical to the proper administration of the federal securities laws. The Second Circuit's creation, by judicial implication, of a disgorgement remedy never granted by Congress cannot be reconciled with recent decisions of this Court, and its rejection of traditional limitations applicable to equitable relief in federal court is at odds with the law in other circuits. The Second Circuit's treatment of those issues plainly warrants further review.

I. THE SEC'S DISGORGEMENT ORDER CLASHES WITH THIS COURT'S RULINGS LIMITING IMPLIED REMEDIES

There is no inter-circuit conflict on the first issue presented. That is traceable to the fact that the Second Circuit has long been the dominant "mother circuit" in the

field of federal securities litigation given its geographical link to the New York financial markets. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting). This dominant position often leads the Second Circuit, as happened in this case, to rely solely on its own precedents in resolving important federal securities law issues. Other circuits have uncritically followed the lead of the Second Circuit, declining to retrace its original steps in *Texas Gulf Sulphur* or to determine whether disgorgement comports with this Court's more recent precedents. Given the entrenched misconception of the law in the lower federal courts on the issue of disgorgement, the absence of a conflict in no way detracts from the certworthiness of this case. The Second Circuit's decision qualifies for review because, in the words of Rule 10(c), the decision raises critical issues of federal statutory interpretation that "have not been, but should be, settled by this Court," and the Second Circuit has so far departed from the accepted course of statutory interpretation of the federal securities laws "as to call for an exercise of this Court's supervisory power." Sup. Ct. R. 10(a).

This Court has not hesitated to grant certiorari and reverse lower court decisions when expansive constructions of the securities laws, such as the one in this case, conflict with the literal language that Congress has used or with rules of statutory interpretation laid down by this Court. *See, e.g., Central Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164, 192 (1994). The existence of an inter-circuit split is by no means a prerequisite for certiorari to be granted when important questions are raised concerning the securities laws. *See, e.g., Dirks* v. *SEC*, 463 U.S. 646 (1983); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551 (1979); *SEC* v. *Sloan*, 436 U.S. 103 (1978); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462 (1977); *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975); *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49 (1975); *see generally*, 1 Bromberg & Lowenfels, SECURITIES FRAUD AND COMMODITIES FRAUD 2:108 (1996) ("There can be little doubt about the intensity of the Court's concern over the

expansion of securities liability, and its determination to curb.").

The first question presented is a frequently recurring one of exceptional practical importance. The judge-made disgorgement remedy fundamentally enhances the bargaining position of the SEC. In hundreds if not thousands of settled cases, the agency can use the threat of massive disgorgement to intimidate securities professionals, corporations and other securities law defendants into accepting onerous settlement terms. Given the near-complete deference the SEC receives from lower courts, as demonstrated by this case, the Commission now exercises uncodified, but immense and effectively unreviewable powers in a critical sector of the private economy.

The disgorgement remedy claimed in this case is so far removed from the language of the 1933 and 1934 Acts that it did not occur to the SEC to seek it for more than 30 years.[4/] In *SEC* v. *Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir. 1971), the SEC was granted disgorgement powers for the first time in a contested enforcement proceeding. Since then, despite the absence of any statutory authority and despite the absence of any support from legislative history, disgorgement has, according to a former general counsel of the SEC, grown into "the principal

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[4/] In the words of a leading scholarly study (Ellsworth, *Disgorgement in Securities Fraud Actions Brought By The SEC*, 1977 Duke L.J. 641, 642): "Nowhere within the statutory framework of the federal securities laws did Congress provide that the SEC would have the power to make a violator of the anti-fraud provisions disgorge tainted profits. Nor is there any direct reference in the legislative history surrounding the passage of the 1933 or the 1934 Acts which would encourage the utilization of such an enforcement tool by the SEC. It would appear that the dearth of legislative support dissuaded the Commission for some three decades from testing in court the right to obtain such relief." Nevertheless, "[o]ver the last fifteen years the SEC has obtained, with increasing frequency and on a scale unprecedented in administrative law, a broad range of equitable remedies, generally known as 'ancillary remedies' or 'ancillary relief' — not expressly authorized by federal statutes." Dent, *Ancillary Relief in Federal Securities Law: A Study in Federal Remedies*, 67 Minn. L. Rev. 865, 865 (1983).

equitable remedy sought by the Commission."[5/] As demonstrated below, the disgorgement remedy was fashioned by the courts in an era of expansive interpretation of the securities laws, which assumed the propriety and desirability of an active law-making role by the federal judiciary in carrying out broad remedial statutory goals, regardless of what the statute expressly stated. That approach, however, has now been firmly rejected by this Court. The precisely-calibrated remedial scheme that Congress put in place to deter and punish securities law violators simply does not provide for the kind of ad hoc disgorgement remedy fashioned here.[6/] Given the current, widespread use of disgorgement in SEC enforcement actions, this case warrants further review.

A. This Court's Recent Decisions Forbid The Creation of Implied Remedies That Distort The Scheme of Remedies Expressly Fashioned by Congress.

1. Judicial revision of explicit remedies. No one disputes that the federal securities laws do not expressly allow courts to grant disgorgement. Courts awarding disgorgement, therefore, have been forced to rely on two provisions enabling the Commission to seek only *injunctive* relief. Section 20(b) of the 1933 Act, 15 U.S.C. § 77t(b), and Section 21(d) of the 1934 Act, 15 U.S.C. § 78u(d), empower the SEC to bring a civil action "to enjoin" specific "acts or practices" that constitute a violation of the statute. The relief available to the SEC is specifically described: "Upon a proper showing, a permanent injunction or temporary injunction or restraining order shall be issued." If deterrence of future misconduct is called for, the SEC may "transmit such evidence as is available" to the Attorney General, who "may institute the necessary criminal

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[5/] Ferrara, *Hardball! The SEC's New Arsenal of Enforcement Weapons*, 47 Bus. Law. 33, 73 (1991).

[6/] "The results of the case-by-case approach, which now prevails, are that the district courts are assuming the essentially legislative function of defining remedies for statutory violations, often disregarding the purposes of the securities laws." Dent, *Ancillary Relief, supra*, 67 Minn. L. Rev. at 927.

proceedings." *Id.* This is not a case where the statute empowers a court to enter an "injunction, or *other order*." *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 399 (1946) (emphasis supplied). The provisions at issue here, by their clear terms, authorize injunctive relief only and make no mention of any catchall language which might authorize disgorgement.

Despite the "forward looking" and limited nature of the injunctive remedy expressly prescribed in the securities laws, courts have implied from that narrow remedy the ability to "reach back" in time and order disgorgement of profits, even from long ago. In the seminal disgorgement case, *Texas Gulf Sulphur Co.*, 446 F.2d at 1307-08, the Second Circuit grafted onto the SEC's express power to seek limited injunctive relief an implied power to obtain unlimited disgorgement. The court recognized that nothing in the text of the statute authorized disgorgement, and that the "legislative history" may be "contrary" to such a remedy, but nonetheless based the disgorgement remedy on "general equity powers under Sec. 27 of the Act." *Id.* at 1307. The focus of the court's inquiry was not on the words of the statute, but rather on the court's own judgment as to whether disgorgement would "effectuate the purposes of the [securities laws]." *Id.* at 1308. Decisions following *Texas Gulf Sulphur* have offered no substantive explanation of how the disgorgement power can be implied from the securities laws other than reliance on broad remedial purposes. The analysis in *Texas Gulf Sulphur* conflicts with this Court's jurisprudence (*see infra* pp. 13-20), and those errors have simply replicated themselves over the years without any critical reconsideration.[7/]

Although originally considered to be "ancillary" to the injunctive remedy expressly provided by statute, disgorgement has grown into the primary remedy employed by the SEC. As recently as 1986, for instance, only ten reported federal court decisions addressed the issue of

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[7/] *E.g.*, *SEC* v. *Materia*, 745 F.2d 197, 200 (2d Cir. 1984) ("any form of ancillary relief may be granted where necessary and proper to effectuate the purposes of the statutory scheme").

disgorgement in the context of SEC enforcement actions. In 1996, by contrast, there were over 40 such decisions.[8/] Disgorgement has become a nearly $1 billion per year implied remedy for the SEC. The $75 million disgorgement award below — reaching back over ten years — is the latest and most striking example of how a so-called "ancillary" implied remedy has grown to dominate the enforcement scheme.[9/]

The consequences of that development have been dramatic. To begin with, SEC injunctions are by no means a "mild prophylactic" but rather, represent "drastic remedies." *Aaron* v. *SEC*, 446 U.S. 680, 703 (1980) (Burger, C.J., concurring). Given the additional implied remedy of disgorgement, the SEC's leverage over securities professionals and market participants increases enormously, especially considering the near-complete deference which the SEC receives from lower courts with regard to awarding disgorgement, as shown by this case. The end result is that the SEC has vast and effectively unreviewable powers that are nowhere codified in any statute. This Court has warned against such a result: "Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy . . . [which] can be hazardous . . . ." *Dirks* v. *SEC*, 463 U.S. 646, 664 n.24 (1983); *see also SEC* v. *Sloan*, 436 U.S. 103, 123 (1978) (Brennan, J., concurring) (describing expansive SEC sanctions as "flagrantly abusive . . . . no reasonable person could suppose that Congress intended to authorize such a thing"). As former SEC Commissioner Roberta Karmel has explained, "[t]he potential for abuse is great when a government prosecutor is not held to the limitations and standards of a

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[8/] This survey was limited to cases reported on Westlaw, and accordingly does not take into account a large number of other disgorgement cases, including those in which the defendants consented to the relief sought.

[9/] *See, e.g.*, Stern, Gressman, Shapiro & Geller, SUPREME COURT PRACTICE 188 (7th ed. 1993) (the fact that "especially large amounts of money are involved in litigation over the issue of statutory construction may also be a persuasive factor" in granting certiorari, especially where "the amount is enormous").

specified statutory remedy." Karmel, REGULATION BY PROSECUTION 201 (1981). [10/]

2. The requirements of separation of powers. Judicial implication of a remedy like disgorgement, so frequently employed and so far-reaching in impact, raises profound questions concerning the separation of powers. Indeed, *Texas Gulf Sulphur* and its progeny are directly at odds with this Court's jurisprudence, which demands "respect" for "the compromise embodied in the words chosen by Congress," *Mohasco Corp.* v. *Silver*, 447 U.S. 807, 826 (1980), and recognizes that Congress, rather than the judiciary, should control the availability of controversial remedies for violations of federal statutes. *See Northwest Airlines, Inc.* v. *Transport Workers Union of America*, 451 U.S. 77, 95 (1981); Easterbrook, *Statutes' Domain*, 50 U. Chi. L. Rev. 533, 540-42 (1983) (since the 1934 Act "already comes right up to the line in offering protection for investors," additional implied remedies undermine the statutory "compromise").

Accordingly, where Congress has expressly authorized specific remedies — as it has repeatedly done in the federal securities laws — this Court has held that courts should not override Congress's intent by implying additional remedies not expressly authorized by statute. Indeed, "it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court

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10/ *Accord* Freedman & Sporkin, *The Securities and Exchange Commission's Enforcement Program: A Debate on the Enforcement Process*, 38 Wash. & Lee L. Rev. 781 (1981) (comments of Professor Freedman) ("The enforcement work of the Commission, at best, reflects an over-zealous insensitivity to individual liberties and the values of a free society, and, at worst, a deliberate pattern of serious and inexcusable violations of fundamental rights and elementary notions of fairness"); Kripke, THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE 51 (1973) (the SEC is prone to engage in "retribution against those who do not play the game of giving the staff an easy victory by negotiating a consent decree without trial"); Dent, *supra*, *Ancillary Relief*, 67 Minn. L. Rev. at 894, 925-926 (disgorgement remedies "can also produce error costs, including hindrance of capital formation. . . . One cannot meet these objections by assuming, in light of past behavior, that the Commission will restrain itself").

must be chary of reading others into it." *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 19 (1979). In view of the comprehensive and precisely-calibrated scheme of remedies in the federal securities laws, courts should not assume that "Congress absent-mindedly forgot to mention" an additional remedy. *Id.* at 20.[11] In *Transamerica*, the Court held that express provisions for injunctive relief under the Investment Advisers Act, 15 U.S.C. § 80b-1, negated the existence of any implied private damage action. *Id.* As one commentator has observed, "[t]hat the express remedy also negates ancillary relief would seem to follow a fortiori." Dent, *supra, Ancillary Relief,* 67 Minn. L. Rev. at 891.

It is hard to imagine a system of rights and remedies more elaborate than that created by the securities laws. Over sixty specific sections or subsections expressly provide a host of remedies for violations of the securities laws in civil actions brought by private plaintiffs or the SEC, in administrative proceedings before the SEC, and in criminal prosecutions initiated by the Department of Justice.

As already discussed, the SEC may seek injunctive relief from the courts. It is specifically authorized, in many sections of the securities laws, to seek civil penalties from courts or to impose them administratively.[12] The securities laws give the SEC extensive authority to regulate and

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[11] *See also, Texas Indus., Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 644 (1981) (no implied right to contribution given existence of "detailed" and "specific" remedial provisions in antitrust laws); *Northwest Airlines*, 451 U.S. at 93-94 (1981) ("The comprehensive character of the remedial scheme expressly fashioned by Congress strongly evidences an intent not to authorize additional remedies"); *Middlesex County Sewerage Authority* v. *National Sea Clammers Assoc.*, 453 U.S. 1, 14 (1981) ("In view of these elaborate enforcement provisions it cannot be assumed that Congress intended to authorize by implication additional judicial remedies").

[12] 15 U.S.C. §§ 77*t*(d)(1), 77t(d)(2)(A), 78u(d)(3)(A), 78u-2(a), 78ff(b), 78ff(c)(2)(C), 80a-9(d), 80a-41(e), 80b-3(i), 80b-9(e)(2)(B). Indeed, Congress even established a multi-tiered system for determining the appropriate size of any civil penalties imposed under these sections. *See, e.g.*, 15 U.S.C. § 78u(d)(3)(B).

discipline persons who do business in the securities markets,[13] including the authority to seek court orders barring violators of the securities laws from serving as officers or directors of corporations.[14] In addition, through administrative proceedings, the SEC can seek cease and desist orders.[15]

Most importantly for purposes of this petition, and in sharp distinction to the authority granted to it in civil enforcement actions, *in administrative proceedings* the SEC is specifically authorized by the securities laws *to seek disgorgement*.[16] Congress's decision to allow disgorgement in carefully-specified administrative proceedings in the Securities Enforcement Remedies And Penny Stock Reform Act of 1990, Pub. L. 101-429, 104 Stat. 931 (1990), makes clear that the text of the original 1934 Act did *not* authorize such a remedy under its general injunctive provisions. Congress's express listing of comprehensive remedies, therefore, implies the exclusion of a general disgorgement remedy, especially given the fact that Congress has provided for disgorgement in certain circumstances but not in others. It is particularly significant that the same provisions which provide for injunctive relief go on to state that serious wrongdoing should be referred to the Department of Justice for criminal prosecution. 15 U.S.C. §§ 77t(b), 78u(e). Nowhere has Congress granted the federal courts power to order the disgorgement of $1, much less $75 million, in a civil suit brought by the SEC. *See SEC* v. *Sloan*, 436 U.S. at 112 (where the SEC seeks "awesome power with a potentially devastating impact," a "clear mandate from Congress" is "necessary to confer this power").

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[13] *See, e.g.*, 15 U.S.C. §§ 78o(b)(4), 78o(b)(6), 78o(c)(4), 78o-4(c)(2), 78o-5(c)(1)(A), 78o-5(c)(1)(C), 78s(h), 80a-9(b), 80b-3(e), 80b-3(f).

[14] 15 U.S.C. §§ 77t(e), 78u(d)(2), 80a-35(a).

[15] 15 U.S.C. §§ 77h-1, 78u-3, 80a-9(f), 80b-3(k).

[16] 15 U.S.C. §§ 77h-1(e), 78u-1(e), 78u-3(e), 80a-9(e), 80a-9(f)(5), 80b-3(i)(4)(j), 80b-3(k)(5).

The judicially-created disgorgement remedy is, in effect, an attempt by judges to rewrite the already comprehensive federal securities laws to "improve" their functioning. But courts are ill-suited, as a matter of institutional and constitutional competence, to perform the investigation and balancing of interests necessary to craft a complex remedial scheme. *See Bush* v. *Lucas*, 462 U.S. 367, 389 (1983). The only sensible response to the SEC's demand for disgorgement power, and the only solution consistent with fundamental principles of separation of powers, is to send the SEC back to Congress to obtain a legislative judgment on the availability and appropriate range of disgorgement remedies in federal court, complete with congressionally-defined substantive and procedural safeguards which are missing here (*see infra* pp. 17-18).

Recent experience under other analogous statutes confirms the need for congressional review of controversial policy issues before recognizing the sweeping disgorgement remedy demanded by the SEC. For example, under the Federal Trade Commission Act, the Federal Trade Commission argued unsuccessfully that its "cease and desist" powers encompassed an implied power to seek restitution. *See Heater* v. *FTC*, 503 F.2d 321, 325 (9th Cir. 1974) (finding serious problems of fair "notice" to the defendant, particularly where the refund order ran against an individual who "only constructively received those funds" through a then-bankrupt corporation). Congress responded to this ruling by passing a new Section 19 of the FTC Act in the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act of 1974, 15 U.S.C. § 57b. Congress carefully considered a variety of dangers of abuse in such proceedings and set forth specific substantive and procedural safeguards and restrictions designed to assure fundamental fairness.

The completely undefined nature of the disgorgement remedy, which is a recent phenomenon in securities litigation, makes it an especially inappropriate candidate for judicial implication. Recognition of a disgorgement remedy, without a statutory basis, requires courts to make open-ended legislative decisions on a host of complex and controversial subjects. As one authority has observed, "there is not as yet

any really good working structure that defines what we mean by unjust enrichment." DOBBS ON REMEDIES 226 (1973). The Second Circuit's amorphous rule — that the contours of disgorgement are simply a matter of "discretion" — ignores the principle that Congress is best situated to make these policy judgments.

When courts create disgorgement remedies without guidance from Congress, they must themselves legislate on a host of policy issues:

• **What rules apply to the calculation of disgorgement?** Having found a violation, the courts below required disgorgement even of profits that were not traced to any unlawful conduct. App. 100a. The courts then required petitioner Brennan to disgorge these amounts even though he never received them. *Id.* at 101a. Would Congress have viewed this punitive use of disgorgement as appropriate?

• **Who gets the money?** The SEC stated repeatedly in the district court that it was not seeking disgorgement to compensate injured investors (*see supra* p. 5), thereby avoiding dismissal of its claim in light of the class settlement. *See e.g.*, *FTC* v. *AMREP Corp.*, 705 F. Supp. 119, 124 (S.D.N.Y. 1988) (agency pursuit of monetary relief for benefit of settled class barred by *res judicata*). Only after it obtained its award did the SEC profess that it was "not yet clear where the disgorged proceeds will go," adding that some funds may go to investors, while "some or all of the disgorged money may eventually go to the U.S. Treasury." SEC App. Br. 47-48. Would Congress have approved this speculative and uncertain form of disgorgement, especially of profits the defendant did not actually receive?

• **Does disgorgement include prejudgment interest?** Where Congress has made a policy decision that *post*judgment interest in civil cases should be calculated using a defined rate, but in contrast has not adopted a fixed statutory formula for calculating *pre*judgment interest, leaving it instead to the discretion of district court judges on a case-by-case basis, would Congress countenance the approach adopted in this case, namely the application of the

same enhanced rate of interest to each case regardless of the circumstances?

• **Are there any time limits on disgorgement?** Congress has provided express statutes of limitations for damages actions and for penalty proceedings. *See infra* pp. 28-29. Criminal fines also must be pursued within a statute of limitations. Would Congress have wanted the SEC to pursue disgorgement many years after the events in question, while interest accrues at a punitive rate?

• **Does the defendant get a jury trial?** By artificially engrafting the new "disgorgement" remedy on the "injunction" provisions of the securities laws, the courts below effectively nullified the jury trial right that ordinarily applies whenever the government seeks to impose a monetary penalty to achieve "deterrenc — the purpose avowedly served here. *See infra* pp. 27-28. Would Congress have viewed this massive sanction (which resulted in the bankruptcy of both the corporation and its owner) as an "equitable" remedy?

These are important policy issues, on which Congress should speak. Courts should not invent rules of decision on these points in contradiction of the express and comprehensive remedies that Congress actually prescribed. As noted by former SEC Commissioner Karmel, "it is incumbent on Congress to review and adapt its legislative directives, in order to avoid leaving what are, in effect, legislative tasks to the courts by default." Karmel, *supra*, at 194.

B. The Disgorgement Remedy Rests On An Outmoded Method of Statutory Interpretation And Threatens To Undermine Congress's Manifest Intent.

1. The irrelevance of generalized purpose. Judicial implication of a disgorgement remedy is the product of a now-discredited line of cases interpreting legislation in light of generalized statutory purpose rather than the actual language employed by Congress. The leading example of this outmoded approach to statutory interpretation is *J.I. Case Co.* v. *Borak*, 377 U.S. 426, 433 (1964), in which this Court recognized an implied cause of action under Section 14(a) of the Securities Exchange Act of 1934, and in

doing so emphasized "the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." The Court further stated that "[i]t is for the federal courts to adjust their remedies so as to grant the necessary relief where federally secured rights are invaded" and that "courts may use any available remedy to make good the wrong done." *Id.*

The *Borak* approach, on which *Texas Gulf Sulphur* and the implied disgorgement remedy rest, has in more recent years been soundly repudiated by this Court in favor of an approach that adheres to the words of the statute. Two cases are of particular importance. First, in *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979), this Court expressly rejected the reasoning behind *Borak* and *Texas Gulf Sulphur*, emphasizing instead that in determining whether a given remedy exists, a court's "analysis must begin with the language of the statute itself." In concluding that there was no implied private cause of action under Section 17(a) of the 1934 Act, the Court stated that "generalized references to the remedial purposes of the 1934 Act will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'" *Id.* at 578 (*quoting SEC* v. *Sloan*, 436 U.S. 103 (1978)). The Court stated that the "ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.*

Thus, the disgorgement decision in *Texas Gulf Sulphur* can no longer be considered good law. While the court in *Texas Gulf Sulphur* relied upon "general equity powers under § 27 of the Act," 446 F.2d at 1307, in *Redington* this Court squarely held that "Section 27 grants jurisdiction to the federal courts and provides for venue and service of process. It creates no cause of action of its own force and effect; it imposes no liabilities. The source of plaintiff's rights must be found, if at all, in the substantive provisions of the 1934 Act . . . not the jurisdictional provision." 442 U.S. at 577. Furthermore, in *Redington*, this Court declined to create an implied monetary remedy because the statutory provision in question "is forward looking, not retrospective." *Id.* at 570. Of course, the injunctive provisions here at issue are similarly (and exclusively) "forward looking" in nature.

Any lingering doubts about the continued vitality of the "purpose" approach of *Borak* and *Texas Gulf Sulphur* were put to rest in *Central Bank of Denver* v. *First Interstate Bank of Denver*, 511 U.S. 164 (1994), where this Court repudiated decades of lower court decisions that had recognized an implied private right of action for aiding and abetting violations of Section 10(b). The Court stated that "the text of the statute," which nowhere provided for aiding and abetting liability, "controls our decision." 511 U.S. at 173. The Court rejected the argument that "a broad based notion of congressional intent" could support the imposition of aiding and abetting liability, *id.* at 180-81, and refused to equate congressional inaction with specific statutory authorization. *Id.* at 1453. *See also Board of Governors* v. *Dimension Financial Corp.*, 474 U.S. 361, 373-75 & n.7 (1986):

> Application of the "broad purposes" of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. Congress may be unanimous in its intent to stamp out some vague social or economic evil; however, because its Members may differ sharply on the means for effectuating that intent, the final language of the legislation may reflect hard-fought compromises. Invocation of the plain purpose of legislation at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of Congressional intent.[17/]

[17/] *Touche Ross* and *Central Bank* are among a long line of cases — in the securities law context and beyond — in which this Court has adhered strictly to statutory language, regardless of the broad remedial purposes that can be imputed to the legislation at issue. *See, e.g., Dunn* v. *CFTC*, 117 S. Ct. 913, 916 (1997) (in "apply[ing] the statute as Congress wrote it," Court found trading in off-exchange foreign currency options to be exempt from regulation); *SEC* v. *Sloan*, 436 U.S. 103, 118 (1978) (SEC not statutorily authorized to issue series of orders suspending trading in stock based upon single set of events); *Santa Fe Indus., Inc.* v. *Green*, 430 U.S. 462, 472 (1977) ("language of 10(b)" requires more than mere breach of fiduciary

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2. Congress's specific intent. Confirming the statute's plain language, the legislative history counsels strongly against the implication of a disgorgement remedy. In passing the 1933 and 1934 Acts during the depression, Congress deliberately attempted to strike a balance that would protect investors while avoiding burdens on business that were inconsistent with economic recovery. *See, e.g.*, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 3 (1934) (the 1934 Act was "conceived in a spirit of the truest conservatism"). It is not surprising therefore, that, as detailed above, Congress focused on a limited, well-defined and precisely-calibrated set of remedies. The House Committee report lists four separately enumerated remedies, including suits by purchasers to protect their own rights, criminal prosecutions, and revocation of the registration of securities. As to injunctive relief, the report is explicit: "The government may *stop further or threatened fraud or misrepresentation by injunction* in the district courts." *Id.* (emphasis supplied). *Accord* S. Rep. No. 792, 73d Cong., 2d Sess. 22 (1934) (emphasis supplied) (the bill "authorizes the Commission to sue in United States courts *for an injunction against threatened violation*"). The focus is forward looking; there is no mention of a disgorgement remedy. Nor can broad ancillary remedies, such as disgorgement, be deemed part of the legislation on the basis of any "tradition of ancillary relief in administrative law in 1933-1934 for the obvious reason that federal administrative law did not exist to any significant degree at that time." Dent, *supra*, *Ancillary Remedies*, 67 Minn. L. Rev. at 926.[18]

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[17](...continued)
duty); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976) (regardless of statute's "remedial purposes," statutory language does not permit liability on the basis of negligence).

[18] In an earlier era of statutory interpretation, this Court sometimes construed statutory authorizations of injunctive relief as also encompassing limited restitutionary remedies. But it consistently recognized the inappropriateness of doing so where implication of a new remedy would upset the comprehensive and balanced array of remedies prescribed by Congress. *E.g.*, *Porter* v. *Warner Co.*, 328 U.S. 395, 402-03 (1946) (simple (continued...)

II. BY ALLOWING DISGORGEMENT TO BE USED AS A PENALTY, THE SECOND CIRCUIT HAS CREATED AN INTER-CIRCUIT CONFLICT ON AN IMPORTANT STATUTORY ISSUE

When courts proceed to invent sweeping new remedies, as they have with disgorgement, they must also (as we have explained) prescribe rules determining the amount of recovery, the proper recipients, the limitations periods for bringing suit, the interest rate for prejudgment interest, and the role of juries. The great deference shown by courts to the SEC, as reflected in the opinions below, means that there are few effective checks on the Commission's ability to determine such issues. While this case emphatically demonstrates that such policy decisions are better left to Congress entirely, if this Court determines that disgorgement is an appropriate implied remedy without statutory authorization, this case also demonstrates the compelling need for the Court to define the scope of the remedy. The Second Circuit's decision removes any meaningful limitations on disgorgement, transforming it from an equitable remedy to a penalty of massive proportions. The failure of the Second Circuit to limit disgorgement to the illicit gains actually received by petitioner Brennan not only creates a split with every other court that has addressed the issue, but also has far-reaching adverse consequences.

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[18]/(...continued)
"return" of funds is authorized where the act does not "expressly or impliedly preclude[] a court from ordering restitution . . . [t]his is not a situation where a statute created a right and has provided a special and exclusive remedy, thereby negativing any jurisdiction that might otherwise be asserted"); *Mitchell* v. *Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291 (1960) (authorizing simple "reimbursement" of lost wages absent a "clear" indication or "inescapable inference" that Congress intended other remedies to be exclusive); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 391 (1970) (recognizing an implied private remedy where Congress proscribed certain conduct and made unlawful contracts "void," but acknowledging the inappropriateness of additional judge-made remedies where Congress has "meticulously detailed the remedies available").

A. The Panel's Affirmance Of An Order Requiring Brennan To Disgorge The Gains Of Another Person Is An Unprecedented Departure From Settled Law.

1. The punitive nature of the order. The Second Circuit's decision should be reviewed by this Court because it creates significant uncertainty as to how a disgorgement award may be determined — removing (for the first time in any reported case) important limitations that keep the *equitable remedy* from becoming a *penalty*. In affirming the $75 million disgorgement award against Brennan, the decision below violated the fundamental principle — heretofore applied in every court to address the issue — that the SEC's disgorgement remedy may reach only the illicit profit a defendant *actually receives*. *See SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) ("The court's power to order disgorgement extends only to the amount with interest by which a defendant profited from his wrongdoing. Any further sum would constitute a penalty assessment"); *accord SEC* v. *Bilzerian*, 29 F.3d 689, 696 (D.C. Cir. 1994); *Hately* v. *SEC*, 8 F.3d 653, 656 (9th Cir. 1993); *SEC* v. *Washington County Utility District*, 676 F.2d 218, 227 (6th Cir. 1982). To the extent an order of disgorgement goes beyond the amount that a defendant actually receives, the order no longer can be considered an equitable remedy but instead constitutes a form of punishment inflicted for deterrent purposes, a result decidedly at odds with traditional principles of equity. *See Estate of Pidcock* v. *Sunnyland Am., Inc.*, 726 F. Supp. 1322, 1340 (S.D. Ga. 1989) ("disgorgement extends only to the profit a defendant actually received").[19/]

19/ *See SEC* v. *Graystone Nash, Inc.*, 25 F.3d 187, 193 (3d Cir. 1994), holding that the district court erred in ordering defendants to disgorge $60 million, while precluding the individual defendants from offering evidence of how much they actually received from a corporate defendant. *See also SEC* v. *World Gambling*, 555 F. Supp. 930, 931 (S.D.N.Y.), *aff'd mem.*, 742 F.2d 1440 (2d Cir. 1983), holding that no matter how extensive a defendant's participation in the fraud at issue, "he should not be required to disgorge what he did not receive." Requiring disgorgement of the full amount of profit from each of the defendants — regardless of what they each

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Especially in light of the Second Circuit's status as the "mother court" of federal securities litigation, *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting), this decision legitimates a sweeping and improper *expansion* of the scope of the disgorgement remedy. Unless corrected by this Court, the Second Circuit's decision, which departs markedly from *all* prior precedents, threatens to enlarge the reach of this judge-made remedy beyond all appropriate bounds.

The SEC identified no case authorizing such a sweeping application of the disgorgement remedy in its brief on appeal, was unable to do so when questioned during oral argument, and cited no case on point in its post-argument submissions to the panel. In nonetheless affirming the decision below, the court of appeals erroneously relied on prior cases holding that a district court has discretion in calculating the precise amount of disgorgement. *E.g.*, *SEC* v. *Patel*, 61 F.3d 137, 139 (2d Cir. 1995) (the amount of disgorgement "need only be a reasonable approximation of profits causally connected to the violation"). That discretion, however, relates to the calculation of how much an individual has actually received: it is not a license to order one individual to disgorge the gains of another. None of the cases cited by the Second Circuit (or by the SEC in its brief) involves the disgorgement of profits from an individual who demonstrated at trial that he never received them.

The dangers of the Second Circuit's decision are concretely illustrated by this case. Although the compensation Brennan actually received from the alleged fraud was undisputed, the district court's disgorgement award did not stop there. Brennan's total compensation from First Jersey between 1982 and 1985 that is traceable to the allegedly illegal transactions was less than $1 million. App. 228a. Nevertheless, the district court ordered Brennan personally to disgorge the entire $22.3 million in profits earned by First Jersey on those transactions, plus more than $53 million in prejudgment interest. *Id.* at 223a. The SEC

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[19]/(...continued)
actually received — "would constitute a fine, not disgorgement." *Id.* at 935.

made no allegation, and the district court made no finding, that First Jersey lacked a separate existence of its own.[20/] As noted previously, this staggering award forced Brennan into bankruptcy.

The penal nature of this disgorgement order was greatly magnified by the additional award of $53 million in prejudgment interest. Not only was Brennan required to disgorge millions of dollars he never received, but he also was required to pay interest on those phantom profits at a punitive rate — as if he were a person who had failed to pay taxes to the federal government. In contrast to the Second Circuit's ruling, other circuits consistently have held that in each case the district court must carefully balance the equities and articulate a rationale for selecting a particular rate of prejudgment interest. *See Knapp* v. *Ernst & Whinney*, 90 F.3d 1431, 1441 (9th Cir. 1996); *Booker* v. *Taylor Milk Co.*, 64 F.3d 860, 868 (3d Cir. 1995); *Anixter* v. *Home-Stake Prod. Co.*, 977 F.2d 1549, 1554 (10th Cir. 1992). That rule is especially important in cases such as this one, in which prejudgment interest covers a significant number of years. *Anixter*, 977 F.2d at 1554. By affirming the award of $52,689,893.99 in prejudgment interest, the Second Circuit inappropriately jettisoned these traditional requirements in favor of a simple rule — the SEC is awarded whatever rate it asks for, all to advance the "deterrent" or penal impact of the disgorgement award. App. 41a.

2. Erroneous policy justifications for the penalty. Faced with the undisputed fact that Brennan had received only 1/75th of what the district court ordered him to disgorge, the Second Circuit rationalized the district court's

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[20/] Before a party may "pierce" the corporate veil and hold a shareholder liable for obligations of the corporation, he "bears the burden of proof and must demonstrate the misuse of the corporate form and the necessity of disregarding it in order to do equity." *Department of Labor* v. *Berlanti*, 481 A.2d 830, 832 (N.J. Super. Ct. App. Div. 1984). Courts rely on several factors, such as the failure to observe corporate formalities, in order to determine whether the shareholder used the "corporation as his personal business conduit," thereby depriving the corporation of a separate existence of its own. *Walensky* v. *Jonathan Royce Int'l, Inc.*, 624 A.2d 613, 618 (N.J. Super. Ct. App. Div. 1993).

decision on two alternative grounds, neither of which is consistent with prior law and each of which, if followed, would yield an uncontrolled and wholly inappropriate expansion of the disgorgement remedy.

First, the Second Circuit held that Brennan could be ordered to disgorge the profits of First Jersey because he theoretically could have withdrawn — but never did — additional profits from First Jersey as its owner.[21/] There is no precedent for this novel theory of disgorgement. The Second Circuit's decision means that any controlling shareholder (or group of shareholders) would be subject to disgorgement liability for illicit gains of a corporation on the basis that, regardless of the historical facts, the shareholder "could have" arranged to receive higher dividends or otherwise could have withdrawn more money from the corporation. Ordering disgorgement from a defendant of what he hypothetically might have received, rather than what he actually received, radically alters the law of disgorgement. By not requiring any meaningful relationship between the disgorgement and the actual amount of unjust enrichment, the judgment below plainly exacts a forbidden penalty.

The Second Circuit's alternative rationale for affirming the order requiring Brennan to disgorge all of First Jersey's profits — joint and several liability — also marks a significant expansion of the disgorgement remedy and confirms the penal character of this order. The policy goal of joint and several liability, which makes each defendant responsible for the entire amount of damages awarded, is to ensure that injured persons are made whole. *See World Gambling*, 555 F. Supp. at 931. That rationale, however, does not apply here because, as the court of appeals and the SEC acknowledged (App. 39a), disgorgement is "unlike an

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21/ Even under this theory, Brennan could never have withdrawn First Jersey's gross profits of $22.4 million. First Jersey had necessary business expenses, including payroll, rent, sales commissions, and normal overhead. Moreover, the Second Circuit entirely overlooked the fact that Brennan was not enriched by the full amount of compensation he received because he paid taxes on those amounts. *See* Ellsworth, *supra*, 1977 Duke L.J. at 661 (failure to deduct tax payments from disgorgement award exacts an impermissible penalty).

award of damages." Disgorgement is a "deterrent," not a means to compensate injured First Jersey customers, all of whom previously released and settled their claims. Tr. 555, 1059, 1143-45. Indeed, at trial the SEC expressly disclaimed the intention of using any disgorged funds to compensate investors; the entire award, it said, will be remitted to the U.S. Treasury. Tr. 1059. Not only did the Second Circuit overlook the limited purpose behind joint and several liability, but it failed to articulate any other equitable basis for saddling Brennan with the burden of disgorging money he never received. *See World Gambling*, 555 F. Supp. at 931 ("To the extent that joint liability requires payment of a sum greater than the profits unlawfully obtained by the fraudulent transaction, it is a penalty and therefore improper"). The Second Circuit's permissive approach to disgorgement ignores the principle that the SEC's statutory powers are not, and should not be, infinitely elastic; they do not create "a panacea for every type of problem which may beset the marketplace." *Sloan*, 436 U.S. at 116.

B. The Lack Of Any Meaningful Limitations On The Disgorgement Remedy Has Far-Reaching Adverse Consequences.

By engrafting a new "deterrent" remedy upon a statutory provision designed to afford only preventive equitable relief, the SEC now has a ready means to deprive securities law defendants of their right to trial by jury, and to avoid the application of any statute of limitations. These adverse effects — which Congress could not have intended — confirm the need to constrain disgorgement orders which manifestly inflict a penalty.

1. Erosion of jury trial rights. The expanded disgorgement remedy endorsed by the Second Circuit enables the SEC to subvert a basic constitutional protection by the simple expedient of labeling actions for a civil penalty as "disgorgement" proceedings. Since true disgorgement proceedings are characterized as an equitable remedy, a defendant is not entitled to a jury trial. By contrast, SEC actions seeking civil penalties are legal in nature and require that a defendant be afforded a trial by jury should he so desire. *See Tull* v. *United States*, 481 U.S. 412, 423 (1987)

(explaining the traditional distinctions determining whether a jury is available based upon the legal or equitable nature of the claim). Where, however, as in this case, the disgorgement remedy has been expanded to include profits never received by the defendant, the traditional line between equitable "disgorgement" and a legal "penalty" has been crossed by a wide margin. *See Tull*, 481 U.S. at 424-25 (holding that a $22 million judgment was so large that it could not be characterized as incidental to equitable relief, and was therefore a penalty that required trial by jury). Here, this basic constitutional protection vanished altogether based on the fiction that the SEC was seeking a conventional equitable remedy.

It is the character of the relief that determines whether it is equitable or legal and, consequently, whether a right to trial by jury exists. *Woodell* v. *Brotherhood of Elec. Workers*, 502 U.S. 93, 97 (1991). Where the relief sought is plainly "deterrent" or punitive, as here, the action is legal in nature and the Seventh Amendment preserves the right to a trial by jury. *See Tull*, 481 U.S. at 424-25. Nevertheless, because the SEC was able to secure $75 million under the guise of "disgorgement," petitioner Brennan was deprived of that basic constitutional right.

2. Nullification of the statute of limitations. By dressing this massive penalty in the sheep's clothing of an ordinary equitable remedy, the SEC also overrode all protections afforded by congressionally-prescribed statutes of limitations. The Second Circuit refused to apply *any* statute of limitations, and, in fact, did not even address petitioners' detailed arguments on that issue. Where, as discussed above, a securities law defendant has been compelled to "disgorge" profits that he never received (plus interest), and where the defendant has already settled all claims brought by persons who allegedly suffered injury, it is plain that the "deterrent" order sought by the government is neither an equitable nor a compensatory order. Thus, although labeled as "disgorgement," the action seeks a penalty and should be time-barred with respect to claims that arose more than five years before the action was commenced under the statute of limitations applicable to civil penalty actions, 28 U.S.C. § 2462. *See Johnson* v. *SEC*, 87 F.3d 484, 491-92 (D.C.

Cir. 1996) (applying 28 U.S.C. § 2462). If the court below applied the five-year statute of limitations prescribed by Congress for penalty actions, *the SEC's allegations regarding half of the transactions at issue in this case would have been time-barred.* Nonetheless, through the expanded disgorgement remedy endorsed by the Second Circuit in this case, the SEC is now able to avoid *any* limitations period simply by denominating claims that in substance seek civil penalties as claims for disgorgement.[22/]

The policies of the statute of limitations and the securities laws should not be so easily subverted: certainty and repose both are indispensable to the efficient functioning of the securities markets. *See In re Data Access Sys. Sec. Litig.*, 843 F.2d 1537, 1546 (3d Cir. 1988) (*en banc*). The SEC's claim that Congress would have declined to impose *any* time limit whatsoever on disgorgement actions, especially those involving tens of millions of dollars and a decade of prejudgment interest, is not a plausible one. *See Lampf, Pleva, Lipkind, Prupis & Petrigrow* v. *Gilbertson*, 501 U.S. 350 (1991) (imposing a limitation period of one year from discovery and an outer limit of three years from accrual for private claims under Section 10(b) of the 1934 Act). Ultimately, whether the SEC should have the ability, as in this case, to obtain disgorgement with interest at the highest possible rate in stale proceedings is an issue properly left for Congress, not the courts.

22/ The fact that an award is labeled "disgorgement" is not dispositive: "the determining consideration concerns whether the amount so labeled serves a remedial or punitive function." *SEC* v. *Lorin*, 869 F. Supp. 1117, 1121-22 (S.D.N.Y. 1994), *rev'd on other grounds*, 76 F.3d 458 (2d Cir. 1996); *see also Department of Revenue* v. *Kurth Ranch*, 511 U.S. 767, 784 (1994) (state tax considered to be "punishment"); *United States* v. *Halper*, 490 U.S. 435, 448 (1989) ("[A] civil as well as a criminal sanction constitutes punishment when the sanction as applied in the individual case serves the goals of punishment."); *SEC* v. *Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (any disgorgement award that exceeds the amount of the defendant's personal gain would amount to a penalty).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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